May 19, 2004

Standing Committee on Agriculture, Forestry and Environment
First Report of the First Session Sixty-second General Assembly
Agriculture - The Way Ahead

Mr. Speaker and Members of the Legislative Assembly,

FOREWORD

The discovery of a single case of bovine spongiform encephalopathy (BSE) in Alberta on May 20 of 2003 caused havoc in the Canadian livestock industry. The ban on exports to many countries led to a surplus of cattle in Canada, which resulted in a major loss of markets and a severe drop in prices. Although the ban on exports has been lifted partially, the impacts of the crisis persist throughout the country.

The impacts have also had disastrous consequences for Prince Edward Island's livestock industry. The collapse in beef prices and the restricted access to markets has resulted in serious financial losses for producers. A motion was passed during the fall 2003 session of the Legislative Assembly which directed the Standing Committee on Agriculture, Forestry and the Environment to discuss the BSE crisis and its impact on Prince Edward Island in general and on cow-calf operators in particular. (See Appendix A.)

The motion also directed the Standing Committee on Agriculture, Forestry and Environment to invite input from interested stakeholders and others impacted by the BSE crisis so that the implications of this situation can be fully understood and potential remedies identified.

Since January of 2004, the Standing Committee has been meeting on this issue. Shortly after beginning its discussions, it was asked to broaden the scope of its work to the hog industry which had also been experiencing a prolonged period of low prices, seriously affecting the profitability of producers and hindering the prospects of the industry.

Throughout its deliberations, the Standing Committee also recognized that depressed prices and poor markets were adversely affecting other sectors of the agricultural economy, in particular, the potato industry.

The combined effect of depressed prices and poor markets in three of the Island's leading commodities--beef, hogs and potatoes--occurring as they did at the same time, resulted in what some have called "the perfect storm." This largely unprecedented and simultaneous collapse in three of the Island's major commodities has resulted in a major decline in the Island's farm cash receipts, with concomitant drops in spinoff benefits throughout the provincial economy.

The Standing Committee had a total of twelve meetings throughout the winter and early spring of 2004 on this topic. It has heard from 49 interveners, including the Minister of Agriculture, Fisheries, Aquaculture and Forestry; commodity groups; agricultural organizations; representatives of the retail and processing industries and individual producers. (See Appendix B.) The Standing Committee wishes to acknowledge with appreciation those who shared their views and perspectives. It recognizes the tremendous efforts and outstanding cooperation among those and others to find solutions to these issues.

The Standing Committee also recognizes the many long-term and persistent problems facing the agriculture industry in this province and across Canada, and the remarkable resiliency of producers who are determined to survive and prosper. The Standing Committee hopes this report will help to address those problems and point the way to a long-term approach to ensuring greater stability and security in the industry and greater confidence in its future.

In presenting this report, the Standing Committee wishes to emphasize that agriculture is the leading contributor to the Prince Edward Island economy and the foundation for the well-being of its rural communities. As such, all Islanders have a stake in its short and long-term prospects.

INTRODUCTION

The Prince Edward Island agriculture industry is the leading contributor to the provincial economy. Total farm cash receipts are on average more than $350 million annually. The production and processing of agriculture and food products accounts for more than 15 percent of the province's Gross Provincial Product, and that number has been increasing over the past decade. Food products account for more than 75 percent of the Island's exports to international markets.

The industry is also highly integrated. Grain and forage crops produced as part of the potato rotation have made the Island self-sufficient in livestock feed. Potato wastes are a component of livestock feed requirements, and livestock wastes--manure--are an important input for the production of potato and other crops and for building organic matter in soils. Dairy producers account for a portion of calves for the beef industry. Obviously what impacts on one sector will have both direct and indirect impacts on all other sectors.

By value, the leading contributor to farm cash receipts is potatoes, on average accounting for more than 50 percent annually. This is followed by dairy, at approximately $57 million, then by beef and hogs, at about $30 million each. Grain and forage production also account for a significant portion of farm cash receipts and inputs.

Value-added processing of agriculture and food products also contributes significantly to the province's economy. It is estimated that approximately one in four jobs in the province is attributed to the agriculture and food industry, making it far and away the leading contributor to the economy.

Many sectors of the Prince Edward Island agriculture industry are also highly integrated with the rest of Canada, and by extension, with the rest of North America. Prince Edward Island producers to great extent share the same markets and experience the same trends in prices. As a consequence, the Prince Edward Island agriculture industry is vulnerable to the same dynamics of supply and demand as the rest of North American commodity markets. Its limited production has little--if any--impact on overall supply and demand and as a "price taker" it has no influence at all over returns.

In short, Prince Edward Island is totally vulnerable to market conditions and factors determined elsewhere. It is a very small competitor in a very large North American--and world--commodity marketplace where the lowest-cost producers predominate.

The detection of a single case of BSE in Alberta has had as devastating consequences for Prince Edward Island beef producers as it has had for all beef producers in Canada. Downward pressure in North American hog markets has resulted in depressed hog prices in Prince Edward Island. A surplus of potatoes throughout North America, and growing competitive pressures, have resulted in another year of disastrous prices for Prince Edward Island producers and a growing difficulty in accessing traditional markets.

Only in supply managed commodities such as dairy and poultry, where domestic supplies are roughly matched to demand, and where prices are based on costs-of-production, is there some degree of stability and security. Yet, even dairy producers were not insulated from the impacts of BSE, as evidenced by the collapse in prices for cull animals and the loss of lucrative sales of breeding stock to international markets.

THE SITUATION IN BEEF

Although some progress has been made over the past year to re-open the border to partial exports of Canadian beef, the border remains closed to the export of live cattle, one of the keys to helping returning the beef trade to some degree of normalcy. The detection of a further single case of BSE in Washington state in December of 2003 undermined ongoing efforts that had been undertaken to re-open the U.S. border to the export of live cattle. This has further exacerbated the difficulties facing Canadian and Prince Edward Island producers.

A visit by the Chairman of the Standing Committee to Washington in April of 2004 underlined the complexities associated with re-opening the border, and the many competing and conflicting interests at work in the United States on this issue. Predictions about the likely outcome are difficult, especially during an election year. Nonetheless, there are indications that if and when the border re-opens, it will be re-open to exports of older cattle for slaughter only; no replacement heifers would be allowed into the United States from Canada.

The Chairman tabled a letter from the Canadian Ambassador to the United States, Michael Kergin, to the Honourable John F. Kerry of the U. S. Senate. Senator Kerry (among others) had

made representations to U.S. Agriculture Secretary Ann Veneman regarding the proposed rule on imports of live cattle from Canada, raising concerns about a "wall of cattle" backlogged in Canada waiting to flood the U.S. market. In his letter, Ambassador Kergin said that Canada's slaughter rates were up by approximately 18 percent over the same period last year, and feedlot inventories were down by approximately 23 percent. As a result, there is no backlog of either live animals or beef in Canada and fears of a massive influx are unfounded.

Ambassador Kergin expressed the expectation that the USDA would establish its final rule on the basis of fact and science, a view shared by the Standing Committee. It is vital that normal trade in all categories of beef and live cattle resume as soon as possible.

The response by both levels of government and the industry to this crisis has been outstanding. The Canadian investigation of the May 2003 case of BSE was praised by an international panel of experts and by the Office international des epizooties (OIE) and by the Food and Agriculture Organization of the United Nations. Measures were taken by the Canadian Food Inspection Agency to increase the safety of beef products, including the removal of specified risk materials (SRMs) from cattle carcasses older than 30 months. Additional surveillance measures have been announced.

Governments also responded with financial assistance to producers, through such measures as the federal-provincial BSE recovery program and the cull animal program. The Government of Prince Edward Island, on its own, introduced further assistance programs in support of marketing, quality improvements and transportation. In addition, earlier this year, the federal government announced a further $1.0 billion in transitional funding for the agriculture industry, with more than $600 million of that going to livestock producers. These measures are over and above established safety net programs.

In all, the provincial government has committed more than $6.3 million in special assistance programs for the livestock industry.

Consumers are also to be commended for their continued confidence in, and support of, the beef industry. Domestic consumption actually increased over the period, and many retailers also boosted promotion of beef products.

The basic reason for the crisis in the Canadian beef industry lies in the fact that Canada is a net exporter of beef. Restricted access of beef products and the ban on live shipments resulted in a huge over-supply in Canada. The other reason is that Canada has limited processing capacity, and this has created a bottleneck for the industry.

Roughly 90,000 cattle were marketed weekly in Canada before BSE. Of that, 20,000 a week were shipped live to the United States. The Canadian beef demand is for about 40,000 head per week, while the remainder was exported. Canada also imports speciality market requirements. Because processing capacity is about 70,000 head per week, that means there is a huge surplus of live cattle in Canada, and that has resulted in severe price declines. Between May and July of 2003, for example, the price of cattle and calves dropped by about 50 percent.

This situation has mixed impacts on various sectors of the livestock industry. Products from cattle older than 30 months could not be exported, and the demand for cull animals has practically disappeared. Cow-calf operators are some of the hardest-hit, and they have received proportionately less in government assistance.

The Prince Edward Island beef industry is perhaps better positioned that most others in dealing with this crisis. Several years ago, recognizing the decline in per capita beef consumption, and the lack of consistency in locally-produced beef, Prince Edward Island joined with producers in the other Maritime provinces to take a hard look at their industry. This led to the formation of the Maritime Beef Development and Marketing Group which researched and developed a local branded beef product. This has proven to be a significant turning point for the beef industry in the Maritimes.

Since that time, the award-winning Atlantic Tender Beef Classic brand had enjoyed strong demand throughout the region for its consistent high quality. As a branded product, it offers distinctive features and attributes which set it apart from other beef being marketed as an undifferentiated commodity.

The announcement by Hub Meat Packers of its decision to discontinue beef processing at its Moncton facility threatened the survival of this new branded product. This led to the formation of a partnership among producers, Co-op Atlantic and the Government of Prince Edward Island to establish a local beef processing facility. That facility, located in Borden-Carleton, is expected to open in the latter part of 2004.

The establishment of this new facility means that producers have moved up the supply chain, exerting greater control over production and marketing, and establishing a distinct product line which should help insulate it from adverse conditions affecting other sectors of the Canadian beef industry. It also strengthens the relationship among all partners in the supply chain, from producers, through to processors and retailers to consumers.

The Atlantic Tender Beef Classic brand is a model of what is possible for other products being marketed as commodities at the present time.

Prince Edward Island accounts for about 80 percent of the supply under the branded product. And yet, the Atlantic region continues to import close to 80 percent of its beef consumption. Obviously, there is significant potential for the growth and expansion of beef production in Prince Edward Island and throughout the Maritimes.

That potential was reflected in a submission made by the Prince Edward Island Cattlemen's Association to the Standing Committee. Referring to the successful sale of "hooks" in the new beef plant (one hook gives the producer the right and the responsibility to market one animal a year to the plant) the Cattlemen's Association said that "In the year that will be remembered as the year we would like to forget, producers put their faith in the future of the industry..."

Despite the underlying optimism about the future of the beef industry, there is also an underlying unease if long-term conditions don't change for producers. As beef producer Tim Dixon told the Standing Committee, "It is very hard to watch our farm become less and less viable every year. The Dixons have farmed in North Tryon since 1916. I am the only one of the fourth generation to take over and I feel tremendous pressure as this is the first time in history that there has been financial hardship."

Like producers of all commodities, beef producers want to obtain their returns from the marketplace, not from government payments. As the Cattlemen's Association has said, "We want our industry to return to a state of independence where we will not be dependent on government handouts." The Association has said that the new Canadian Agricultural Income Stabilization program looks positive for the beef industry, and has also said that the provincial Beef Industry Development Fund, which supports projects such as the cow/calf and feeder loan cooperatives, is crucial to the continued development and growth of the Island's beef industry.

The Standing Committee recognizes that the beef industry in Prince Edward Island has significant potential. The availability of good pastures, feed grain self-sufficiency, improved genetics and experienced producers all support increased beef production in the province. With a beef processing facility and an established brand, together with the fact the region is not anywhere close to being self-sufficient in supply, that markets are not a constraint to the expansion of the industry. There is every reason to be confident about the future of the beef industry in this province.

Recommendations:

Accordingly, the Standing Committee makes the following recommendations:

1. **Key to the return to normalcy in the Canadian beef industry is the re-opening of the United States border to live cattle. The Standing Committee is concerned that older cattle for slaughter only will be permitted, and that no replacement heifers could be exported. The Standing Committee supports the continued efforts of the Government of Canada to completely remove this and all other market restrictions.**

2. **Because the North American beef market is fully integrated, the Standing Committee supports the Government of Canada in its efforts to seek harmonization of animal health standards and protocols.**

3. **The Standing Committee endorses the financial support which has been provided to livestock producers by the federal and provincial governments. It recommends that both levels of government undertake an annual review of business risk management programs, including the Canadian Agricultural Income Stabilization program, to ensure they continue to meet their objectives.**

4. **The impact of assistance programs has been uneven across the sectors of the beef industry, the cow/calf, background and feedlot sectors. In particular, cow/calf operators have received little direct support from previous assistance programs which have been targeted largely at beef destined for processing and for cull animals. Many cow/calf operators are poised to leave the industry, which would result in a serious under-supply of calves at a time when the industry is seeking to expand. The Committee recommends an immediate payment of $100 per cow to cow/calf operators up to a maximum of 30 cows to help ensure their survival. With a total of some 13,000 beef brood cows in the province, the total cost of this program would be $1.3 million.**

5. **The Standing Committee has heard from the Milk Marketing Board that it has requested the Government of Prince Edward Island to ensure that any new program created for the relief of BSE provide equitable treatment to producers in all sectors that are affected. The Standing Committee concurs with this request. As well, given that the Canadian Dairy Commission determines producer prices, the Standing Committee recommends that the Commission take into account all relevant factors in the marketplace such as the impacts of BSE on the dairy industry when establishing producer prices.**

6. **The Standing Committee has heard that the lack of information is a serious impediment to producers in making marketing decisions. Although the Canadian Cattlemen's Association has begun publication of a "boxed beef report" this is not adequate to enable producers to make more informed decisions. The Standing Committee recommends that the reporting of prices and volumes by packing plants be made mandatory through federal legislation.**

7. **The successful operation of the new beef plant in Borden-Carleton is crucial to the future of the industry. This is especially so, given under-capacity in the Canadian processing sector. The Standing Committee commends producers, the provincial government and the retail partner for investing in this facility. It notes, however, that the federal government has yet to make a formal commitment. Given the importance of this facility to the region as a whole, and in light of the recent federal budget's stated commitment to provide additional venture capital funding for new and expanding enterprises, the Standing Committee recommends that the federal government, through the Atlantic Canada Opportunities Agency, make an immediate financial commitment towards the cost of equipment and other infrastructure for the new plant.**

8. **The BSE crisis has highlighted the importance of traceability and other food safety and quality initiatives. The Standing Committee recommends that the federal government implement a pilot traceability project at the new beef plant with a view to the implementation of a national traceability program in the future.**

These recommendations are aimed at providing short-term support and assistance to the industry to help ensure that it survives beyond the present crisis, and develops a foundation for continued growth and development. Later in this report, the Standing Committee will be making a number of long-term recommendations for the beef industry and for other commodities produced in Prince Edward Island.

THE HOG SITUATION

Although the motion from the Legislative Assembly directed the Standing Committee to meet on the BSE crisis, the Committee was asked early in its deliberations by representatives of the hog industry to broaden its mandate to consider the situation faced by hog producers in the province, which it unanimously agreed to do.

In many respects, the situation facing hog producers is as critical as--if not more than--the situation facing beef producers. The Standing Committee was told by the Income Crisis Committee of the Prince Edward Island Hog Marketing Board that the hog industry is facing a crisis which threatens to put many farming families out of business for good, irreparably damaging the provincial economy.

That the hog industry is a vital part of the agricultural economy is irrefutable. Based on generally-accepted economic multipliers, the spin-off benefits from primary production are as much as six times to the economy. That means for every one dollar generated from farm cash receipts, up to a further six dollars is injected into the economy. With farm cash receipts from hog production as much as $30 million annually, that means the hog industry accounts for a contribution to the provincial economy of more than $200 million.

The hog industry is one of the most progressive in the province. Producers enjoy the highest herd health standards in Canada, and permits must be obtained before any hogs are imported to the Island in order to control the introduction of diseases. Producers here have joined with producers from across the region and, in partnership with the provincial government and the Atlantic Veterinary College, have formed a strong research partnership which enables them to address a wide range of production-related issues. A quality assurance program has been established with respect to production standards.

There is also a strong and growing demand for the Island's high quality genetics, as demonstrated by the sales of breeding stock to domestic and international markets.

Similar to the beef industry, a group of hog producers have partnered with their board and with FoodTrust of Prince Edward Island to develop and market a branded product, Summerside Farms Pork, which has been well-received by consumers. The board has also been active in developing new, specialty pork products in conjunction with the Food Technology Centre.

The quality of hogs going to market has also shown steady improvement, as producers continue to respond effectively to the changing demands of the marketplace. Under the Swine Quality Improvement Program, which provides incentives to producers on the achievement of certain targets for finished hogs, the number achieving compliance has increased from around 50 percent in 1996 to more than 80 percent by 2003.

In short, the industry is progressive and holds a great deal of promise. However, the cycle of low prices has constrained steady and stable growth and affected the viability of producers. As the Interim Chair of the Hog Marketing Board told the Committee, "Even in the last five years, the industry kept investing, mainly in the herd health and environmental side, like manure storage, composting facilities for deadstock, and a cleanout strategy. This, in the expectation that there would be better years ahead. This did not materialize."

Besides hog producers and their representatives, the Standing Committee also heard about the importance of the industry from feed suppliers, machinery dealers, financial institutions and processors. The Standing Committee was told, for example, that unless sufficient hog production can be maintained in the province, the continued operations of Garden Province Meats, a processor with annual sales of $36 million and a payroll of $3.5 million, would be jeopardized.

Certainly the hog industry has encountered major problems over the past six years because of seriously depressed markets. While the industry had been able to adapt successfully to cyclical prices over the years, the recent experience is that of continued low prices with little respite. In 1998, for example, prices plummeted far below the cost of production, and temporary recoveries of prices since that time have failed to compensate for the major losses experienced by producers.

Since 1998, there has been a considerable fluctuation in farm cash receipts for hog producers, from a low of just over $20 million in 1998 to a high of over $33 million in 2001. During that same period of time, production has fluctuated from around 195,000 annually in 1998 to close to 220,000 in 2002.

As the Interim Chair of the Hog Marketing Board told the Committee, "In 1998-1999 there was still equity left on most of our farms. After experiencing low prices over the last five years, there is hardly any, or no, equity left on our farms today."

The Standing Committee was told that over the past six years, it is estimated that producers have sustained a total loss of about $17 million, or $15 on every hog marketed during that time. While production costs vary considerably among operations, there is little doubt that market conditions over the past six years have had a serious negative impact on cash flows, have eroded producers' equities, and have led to a growing lack of confidence in the future of the industry. Already, a number of producers have ceased operations.

The hog industry had been targeted for expansion since the establishment of Garden Province Meats in the early 1980s. Over the years, in cooperation with the Government of Prince Edward

Island, loan programs were instituted for the expansion of the industry, and have been quite effective in helping to modernize and expand production facilities. Repayments were made on a per hog basis at the time of shipment to Garden Province Meats.

During periods of low prices, the provincial government instituted two hog bridge loan programs. Under these programs, producers were eligible for loans once market prices dropped below a certain level, and repayments did not have to be made until prices rose beyond a certain level.
There was also a special loan program put in place to help the industry move to higher herd health standards. Under the depopulation/repopulation program, producers were eligible for loans on the costs of restocking their herds.

Under the various loan programs, a total of more than $12.0 million was provided to producers; of this amount, a total of just over $7.5 million is outstanding. No estimate is available on the level of indebtedness by producers to other financial or trade institutions.

Since the Standing Committee began its deliberations on these and other issues facing the hog industry, market prices have begun to recover to the point that producers are once again receiving prices that exceed their production costs. As well, the provincial government has proposed a new package in support of the hog industry. Hog producers have met, and based on a recommendation from their board, are prepared to move forward with this package.

Under this new package, the targets for repayment have been increased to $1.70 per kilogram, and as the price increases, so does the producer contribution to repayment. The interest rate is equal to the Lending Agency's cost of borrowing plus one percent. As well, an additional $2.0 million is being made available under the Hog Cash Flow Loan program.

Recommendations:

For many years, the hog industry has functioned in a cyclical environment: periods of good prices would help compensate for periods of low prices. In the end, producers were able to survive and carry on. The recent experience of prolonged low prices may indicate a fundamental shift in this pattern, and the Standing Committee will be offering some observations on steps the industry may take in the future to make it less vulnerable to dramatic price fluctuations.

9. **The Standing Committee endorses the consolidation of existing loan programs to help improve producer cash flows and rebuild their equity. It is also pleased to note that an additional $2.0 million is being made available to producers. In response to submissions from the Hog Board, the Committee recommends that repayments under the Hog Loan Consolidation Program begin at $1.75/kg rather than the proposed $1.70/kg, and that the previous trigger for eligibility of $1.40/kg be reinstated.**

10. **The Standing Committee recommends that existing safety net programs such as the Canadian Agricultural Income Stabilization be reviewed annually by the federal and provincial governments to ensure they are responsive to the needs of hog producers.**

11. **The Standing Committee recommends that the provincial government and the Hog Marketing Board begin discussions immediately with a view to developing a long-term program that can help the industry respond more effectively to severe price fluctuations.**

12. **The Standing Committee has heard that the *Natural Products Marketing Act* needs to be updated and streamlined to better reflect the needs of producers. The Committee recommends that the Market Council continue to proceed with its review and updating of the *Act*.**

While these measures may be effective in helping to deal with some of the current and longer-term issues and challenges facing the hog industry, the Standing Committee believes that new marketing strategies are needed to help the industry capitalize and take advantage of certain distinctive strengths and opportunities. These will be dealt with later in the report.

THE PROCESSOR AND RETAILER SITUATION

Canadian consumers spend a lower portion of their disposable income on food than consumers anywhere else in the world. At less than 10 percent of their incomes, Canadians enjoy the cheapest, and arguably, the safest and highest quality and most nutritious food in the world. At the other end of the chain, prices paid to producers have not increased significantly, or have remained relatively flat, over the past two decades, even though overall food prices have risen. The Prince Edward Island Federation of Agriculture told the Standing Committee that the producers' share of the food dollar has declined from 41 percent to just over 20 percent in the last 18 years, a drop of 50 percent.

In light of such numbers, it is tempting to conclude that the "middle men" are taking most of the profits. And for the most part, producers are price takers, not price setters. In such a situation, it is tempting to blame packers, retailers and consumers for taking advantage of the people who produce their food.

If there is any single theme heard by the members of the Standing Committee during the course of its discussions, it is that processors and retailers are profiting at the expense of producers and consumers, particularly during times of volatile markets and low prices. It has heard that the system of food production, processing, distribution, marketing and retailing is weighted heavily against producers and consumers. Producers complain about cheap food policies and consumers wonder why low producer prices are not reflected on store shelves. The litany of allegations go on to suggest that the producers' share of the food dollar is being constantly eroded, that increased consolidation in the processing and retailing sectors is stifling competition, that

consumers are being gouged, that access to local products at the retail level is being denied, and that consumer prices bear little relationship to producer prices.

The Standing Committee believes it is important to address some of these concerns in the context of what is happening in the beef and hog industries, for example. At the same time, the Committee is concerned that producers do not become the weak link in the food chain. Whatever the current situation, the Committee believes that co-operation, not confrontation, is the key to ensuring that all sectors of the agriculture and food industry receive equitable returns from the marketplace.

A brief discussion of the processor and retail sectors is presented to better understand their role in the supply chain.

The Processing Sector

The Standing Committee has heard that increasing concentration in the meat processing sector is destroying competition. On the face of it, given that two transnational companies, Cargill and Tyson, control the bulk of Canadian beef processing and one company, Maple Leaf Foods, is the dominant player in pork processing, it is tempting to conclude that these and related companies exert a major degree of control in the marketplace.

In Canada, the beef processing sector has a total capacity of about 70,000 head per week. A further 20,000 were shipped live to the United States. In total, export markets accounted for about 70 percent of total beef production in Canada prior to May 2003. When the border closed to exports of both live and processed beef, total demand and prices plunged dramatically.

With the markets closed after May 20, 2003, there was a significant over-supply of both processed beef and live cattle in Canada. During this time, Canadian packers operated only to supply domestic requirements, about 40,000 head a week or less.

When markets re-opened to shipments of beef from cattle aged 30 months or less, packers increased production, bringing them to about 90 percent of total capacity over the fall and winter months. Because they are now marketing beef across North America and to some markets overseas, prices to packers are based on supply and demand levels in all the markets it serves. That has helped to increase producer prices somewhat above the disastrous levels during the summer of 2003.

Left out of the market are those animals over 30 months of age because they cannot be exported and also because there is little processing capacity for cull animals. These are the cattle for which extremely low prices continue to prevail. The recent broadening of market entry to cattle over 30 months with SRMs removed has helped alleviate this situation, but the key factor to returning to "normal" trade would be the export of live cattle.

The George Morris Centre, an independent agricultural think-tank at the University of Guelph, in a special report on "Beef Pricing and other Contentious Industry Issues," released in March of 2004, said that since the border re-opening of last summer, pricing of beef at the packer level in many respects is similar to what it was prior to BSE. On the other side, the cattle it purchases from producers reflects a commodity which is in over-supply. "It is rational economic behaviour to pay just what it takes to get the cattle to move to the plant," said the report, explaining why live cattle prices remain so low.

Until U.S. processors have access to the Canadian live cattle market, producers cannot expect to see much of an increase in prices. In the meantime, producers are naturally frustrated to see their prices remain stagnant while packer and retailer prices have rebounded. The question of whether producers are being treated fairly is one that was repeatedly raised during discussions by the Standing Committee.

The Standing Committee heard from the Canadian Meat Council which represents the vast majority of beef processors in Canada, including Cargill, Lakeside, Tyson, and Better Beef, all of which operate federally-inspected plants and which market products domestically and internationally. The Standing Committee wanted to better understand the relationship between pricing at the producer, processing and retail level, and the respective shares of each party in the supply chain.

Despite suggestions that processors stood to make major profits as a result of the BSE crisis, the Standing Committee was told that most processors incurred substantial increased costs and loss of markets, all of which affected margins per head. Some of the reason for that, the Standing Committee was told, is that havoc was created in the Canadian market following the closure of the borders: beef was stranded in the pipeline; products that had been sold overseas had to be kept in Canada for rendering; speciality products such as beef tongues, kidney and tripe that were valued in overseas markets were sold into significantly lower valued markets; and other valuable cuts such as short ribs are also sold to lower-end markets. Some products such as offal have caused losses by as much as $192 a head, there are extra costs in removing specified risk materials (SRMs) and processors are now having to pay costs of rendering, where before rendered products could be sold profitably.

The Canadian Meat Council contends that the loss of the extra value of beef products, combined with higher processing costs and the rise in the value of the Canadian dollar, has had a significant impact on processor margins and profits. Together with the need to continue to invest in new technologies and plant upgrades, especially in view of more stringent regulations, processors contend they need to remain profitable.

The Council also points out that markets are functioning, plants are operating at or near capacity, and that no excessive profits are being made on the backs of producers or consumers.

Closer to home, the Standing Committee also heard from representatives of Garden Province meats, which processes the vast majority of hogs produced in the province, roughly 4,200-4,500

per week. Its is a "kill and cut" operation, and its products are further processed elsewhere and distributed throughout Canada, the United States and a number of countries overseas.

Officials of Garden Province Meats told the Committee they are part of a cyclical hog industry and at the mercy of commodity markets. The plant has identified a number of potential opportunities for value-added products. Representatives told the Committee the plant has incurred losses over the past year.

The Standing Committee has not had the time or resources to fully investigate or further examine the various issues raised by processors. Other jurisdictions across Canada investigating the BSE crisis have been told many of the same things by processors, and the Competition Bureau has not launched a full inquiry into processor profits or allegations of price fixing.

The Committee would however, emphasize that it believes a strong and effectively functioning market at all levels--producer, processor and retailer--is critical if this province and this country is to have an efficient and competitive food system. It recognizes that processors and retailers must continue to make reasonable profits and returns on investment. It is only seeking the same for producers.

The Retail Sector

The retail sector is a strong and growing part of the total supply chain, and its activities have a major influence on the entire food industry.

The Standing Committee heard from the Canadian Council of Grocery Distributors that represents a number of the major Canadian grocery chains. Figures provided by the Council said that the price per kilogram of beef was down by an average of 12 percent in the Maritime provinces during the post-May 20 period. Member retailers promoted beef extensively , including cuts that were in oversupply, and in the meantime, sales of chicken and pork also showed an increase.

The Standing Committee was told that retailers pass pricing on to the consumer that is passed on to them by processors, whether those prices are going up or down, and it is consumers that keep prices competitive. Retailer profit margins are in the range of one to two percent.

It is very difficult to reach firm conclusions about the pricing strategies and competitive positions of retail grocery stores in Canada. Recent consolidations, the impact of technologies, expanded sales of non-food items, management efficiencies, relationships with suppliers and a host of other factors make it difficult, if not impossible, to generalize about this sector which represents about one-quarter of the total retail trade in Canada, or more than $60 billion a year.

Attempts to assess pricing strategies of grocery retailers are also difficult. A study prepared for the Competition Bureau of Canada in 2001 concluded that retailers compete not by price alone,

but also through several dimensions of service quality. As a result of non-price competition through service quality, grocers do not price each item as a proportional markup over unit costs, but instead price each of their products as part of a strategic whole.

A major report prepared by CIBC World Markets on the Canadian grocery industry in 2002 has said that it may be the healthiest supermarket environment in the world. Canadian consumers pay a fair price for groceries, among the lowest in the world, it said. The report suggested that management is experienced, innovative and flexible and that it is by far the best managed sector in Canadian retailing. The report says the industry is highly competitive, and that the growth of discounters such as Wal-Mart Canada is intensifying competition.

Recent consolidations in the industry have resulted in two chains--Loblaws and Sobey's--accounting for about 50 percent of total grocery sales in Canada. Given the low margins and intense competition for market share, it is difficult to make the case that consumers are being gouged.

That was the conclusion reached by the George Morris Centre. "There is a clear answer with regard to why beef prices are not lower at the consumer level," said the report. It explained that there is no surplus of beef at either the consumer or packer level because, since September 2003, Canadian packers have been able to market beef from cattle aged less than 30 months throughout North America and in an increasing number of countries overseas. Since packers are selling product at or near the prevailing North American price, there is little incentive to lower beef prices in Canada.

Producers believe if prices were lower at the consumer level, consumption would rise, helping to alleviate surpluses. The George Morris Centre quotes research saying that for every one percent decrease in price, consumption increases by one percent. If producer prices dropped by 25 percent, consumption might increase by 25 percent, or about 13,000 head nationally a week. That is still lower than the 20,000 live cattle that are surplus in Canada. This clearly underlines the crucial importance of re-opening the border to live exports.

That being said, there appears to be no concerns among consumers about prices; they are not changing purchase decisions because of the price of beef or pork.

The price that consumers pay for their food at grocery stores is a reflection of an extremely complex and dynamic system, including costs for production, processing, packaging, transportation, distribution, warehousing, stocking, marketing, advertising, selling and taxing. While producers complain that their share is decreasing, it must be recognized that the costs of raw product represent only one small portion of the food dollar, and that increases or decreases in the costs of raw product are not proportionally reflected in the final consumer price.

Recommendations:

While it is tempting to blame processors and retailers for taking advantage of the BSE crisis in

the beef industry (and depressed prices in other commodities) the evidence of price gouging is not conclusive.

Indeed, the Commissioner for the Competition Bureau of Canada told the House of Commons Standing Committee on Agriculture and Agri-Food Canada which was studying the pricing of beef at the slaughter, wholesale and retail levels in the context of BSE, there is "no reason to believe that the *Competition Act* has or is about to be contravened," although she did add that the Competition Bureau would continue to examine this issue and would not hesitate to take appropriate action if information was uncovered which points to a potential breach of the Act.

13. The Standing Committee recommends that the Competition Bureau of Canada continue to closely monitor potential breaches of the *Competition Act* at the processor and retailer level and to undertake a full investigation of issues of prices and competition should circumstances warrant.

The Standing Committee believes that the food system in Canada should function in a way such that all partners in the supply chain receive fair and equitable returns. The current approach is based on the principle of scarcity: the pie is only so big, and everyone wants a bigger slice. The approach should be to create more value in each step in the supply chain; producing products consumers want, preserving those attributes throughout the supply chain and delivering services associated with the product that are valued by consumers. Through collaboration, the aim should be to make a bigger pie. This will require greater cooperation and more coordination among all partners.

14. Accordingly, the Standing Committee recommends that all partners in the supply chain undertake to discuss means of closer co-operation and the formation of strategic partnerships to ensure that the food system continues to respond effectively and efficiently to consumers and that the returns are shared more equitably throughout the supply chain. To this end, the Standing Committee recommends the federal government convene a national conference, bringing together producers, processors and retailers to establish a supply chain management approach that provides fair and equitable treatment, and greater stability, to all partners in a mutually-beneficial manner.

15. The Standing Committee fully supports the expansion of processing capacity in the beef industry through the establishment of the new processing plant in Borden-Carleton. With the potential market opportunities for Prince Edward Island pork products, the Committee further recommends the establishment of new value-added processing at Garden Province Meats. In addition, the federal and provincial governments, in cooperation with the Prince Edward Island Food Technology Centre, should continue to explore and identify opportunities for more speciality meat processing in Prince Edward Island.

Although it was not part of the mandate of the Standing Committee, there was considerable discussion about the lack of local products on supermarket shelves. The Standing Committee

recognizes the importance of featuring local products to increase their markets, but also recognizes the specific requirements of retailers in terms of quality and quantity and other attributes. Simply demanding more shelf space is unrealistic, and, as pointed out by a trade analyst who appeared before the Committee, legislating the practice would likely contravene provisions of the Agreement on Internal Trade.

There are also a number of other issues, including consumer awareness, that must be addressed if local products are to be featured more prominently on supermarket shelves. Although many people choose instinctively to purchase local products, consumer research has found that it is not a strong factor in influencing consumer decisions. "Buy...PEI" may have limited appeal to some consumers. But quality, not loyalty, should be the selling point: people do not buy the food we grow; we should grow the food people want to buy.

The Standing Committee was impressed by the willingness of major retailers to feature local products if certain conditions can be met. However, it is crucial that those wishing to enter the market in this way make a solid business case.

16. The Standing Committee recommends that commodity boards and/or groups of producers enter into discussions with retailers to determine how best to feature local products in ways which are mutually beneficial to producers, retailers and consumers.

17. The Standing Committee recommends that the provincial government provide support to increase public awareness of the quality and diversity of local products for both Islanders and visitors.

Producers, processors and retailers are key partners in the supply chain. Strengthening this partnership is key to the success of food production, processing and marketing--and increased and more stable returns to producers.

AGRICULTURE AND FOOD - "THE WAY AHEAD"

In 1999, the Standing Committee on Agriculture, Forestry and the Environment issued a "Report on the Farm Crisis." That report noted many Canadian farmers have experienced crisis conditions as a way of life. It quoted some worrisome trends in Prince Edward Island agriculture: farm debts were increasing significantly; long-term equity was being replaced with long-term debt; average operating expenditures were rising faster than net incomes; safety net programs were inadequate to protect producers against dramatic price fluctuations; and the number of census farms declined by 6.8 percent between 1991 and 1996, the largest drop in any Canadian province.

The Standing Committee concluded: "The entire producer-to-consumer chain needs to be

examined at each step, to determine where value can be added, and to investigate alternate marketing arrangements which could be of greater benefit to producers."

Some six years later --and another round of Statistics Canada and other data--show the farm situation has changed little over that time. Farm cash receipts and expenditures continue to rise, while net incomes remain flat or have declined. In fact, for two of the past three years, net incomes have shown a loss. As noted earlier, declines in beef, hog and potato receipts accounted for lower farm incomes in 2003 and lowered projections for 2004. And perhaps the most chilling figure of all: between 1996 and 2001, the number of family farms in the province dropped by 16.8 percent to 1,845, the largest percentage decrease in the nation, and double the national average. (On the flip side of that, Statistics Canada reports that farms in Prince Edward Island were 18.2 percent larger than in 1996, the largest relative increase of any province.)

In summary, farms in Prince Edward Island continue a decades-old trend to fewer in number and larger in size. Farm incomes remain volatile and, as part of a nation-wide trend, more income comes from off-farm sources. In 2000, net farm income was $21.3 million; income from off-farm sources was $42.6 million.

For years, producers have watched costs rise while prices have failed to keep up. Margins are being squeezed unmercifully. A report by the Centre for Rural Studies and Enrichment said farm input costs rose 28.9 percent from 1986 to1998, while farm product prices increased by only 7.9 percent. To compensate for lower margins and to achieve greater efficiencies, production is increased, resulting in a vicious cycle. Questions are being increasingly raised about the Island's capacity to compete in a high-volume, low-margin, increasingly competitive, globalized commodity-based agricultural model. Resources--both natural and human--are coming under increasing pressure.

The agriculture industry is used to ups and downs, but trends over the past number of years point to an even bleaker future. Canadian farmers are being forced to compete with the heavily-subsidized agricultural industries in the United States and the European Union. Increasing scrutiny from environmentalists and consumers are increasing costs for conservation and food safety measures. Canadians expect high quality food that is cheap, safe and produced responsibly.
This has led many to question why it is the people we entrust to grow our food are having such difficulty surviving.

In its brief to the Standing Committee, the Prince Edward Island Federation of Agriculture said that "our producers have been caught in a cycle that has severely limited their ability to withstand the crisis we now face." It said producers are striving to meet market demands with the added costs they bring, but are selling on a world market that fails to provide sustainable returns to the farm gate. "The cold truth, however," said the Federation, "is that the benefits that have accrued beyond the farm gate have not been enjoyed by our primary producers."

The National Farmers Union went even further in its submission when it called for the "urgent

need" to embark on a new road for Island agriculture. It suggested the application of an industrial business model of food production has had "disastrous consequences for primary food producers, rural communities, the health of the environment, the health and safety of food, the stability of our provincial economy, and the very nature of our social democratic life." The NFU says the age-old survival tactic which farmers have relied upon--hoping next year will pay all the bills and make things right again--will no longer work. "The preferred road for PEI agriculture--and some would argue the only sensible road--is to reclaim our right to determine our own food policies and practices before it is too late," recommends the NFU.

In its submission, the Prince Edward Island New Democratic Party said that the long-term objective should be to secure a market environment that enables farmers to achieve a more reasonable share of the food value purchased. "Agriculture is at a critical point on Prince Edward Island," it said. "Different approaches to farming and food production are urgently needed."

Tim Dixon, a fourth-generation farmer, put it simply and succinctly. Pointing to the Island's pastoral image, he said the Island "should not and cannot compete with generic products from around the world," recommending that the province needs to capitalize on consumers' desire for food produced in a clean and natural environment. "I feel there needs to be a change in the thinking of the leaders of our commodity organizations, " said Dixon, adding that "We need to seek out high end markets that have a higher return to the producer."

That is a view endorsed by the Standing Committee, and it is the principle that the Committee believes should guide the way ahead for agriculture in Prince Edward Island. In short, the Standing Committee's vision of the way ahead for Prince Edward Island agriculture is based on differentiating our products in the marketplace, capitalizing on our healthy environment and pastoral image, putting a Prince Edward Island brand on those products, developing a new relationship with the supply chain and gaining a premium price in the marketplace.

This vision is based on the recognition that the current commodity-based agricultural model is no longer working for Prince Edward Island. The status quo is not sustainable. It is also based on the recognition that markets are becoming increasingly segmented, and that the province has the capacity to respond to new and emerging opportunities in the marketplace.
Research has shown that pricing systems will change to reward producers for the attributes, services and product characteristics they provide to their customers. Making the transition to a new model for agriculture will not be easy, but it will be ultimately rewarding. The change must begin now.

Several years ago, the provincial government announced a Food Strategy for Prince Edward Island based on the production and marketing of high quality, high value products from sustainably managed resources. Since that time, FoodTrust has developed an Island brand and has made the first steps into the market. While progress to date has been slow, a firm foundation is in place to re-position Island food products that will be recognized--and rewarded--in the marketplace. In this way, the substantial investments producers have already made in environmental stewardship can be recouped.

As FoodTrust pointed out in its written submission, there are two options for agriculture: one based on brands and one based on commodities. The Standing Committee believes Prince Edward Island is uniquely positioned to embark on a new direction for the future. This direction is based on the development and marketing of standards, attributes and services that are reflected a distinctive Prince Edward Island brand.

A recent industry-led symposium on the future of agriculture held at the University of Prince Edward Island came to the same conclusion: just as the Island's healthy, pastoral and pristine image lures millions of visitors from around the world, that image can also be a powerful tool in marketing its food products. The Island's isolation means it can boost its phytosanitary and herd health standards. Its tradition of family farms sets it apart from the industrialized agricultural model becoming commonplace throughout the rest of North America. And as an Island, it can more easily differentiate itself in the marketplace, making what is called a "value proposition" healthy food from a healthy environment, or, in the value proposition of FoodTrust, "food that nourishes the body and the soul."

Following are three examples to illustrate what the Standing Committee is proposing.

Beef - Producers from across the Maritimes several years ago recognized they were having difficulty competing against western beef. Quality and supply were seen as inconsistent and unreliable. They developed a standardized feeding protocol based on consumer research, established an award winning brand, and are now able to offer a consistent, high quality product that has met with strong consumer acceptance. Ten years ago, Maritime beef producers faced a bleak future. Today there is renewed confidence. This is an example of what other commodities can achieve.

Hogs - Prince Edward Island has the highest herd health standards in Canada. The Island's physical isolation prevents the introduction of diseases. Pork is produced under a quality assurance program. And yet, Island pork products are marketed alongside all other pork commodities. Research shows consumers are willing to pay extra money for healthier pork. It should be possible to build on the attributes of Island-produced and processed pork products to gain consumer loyalty and more stable returns. This means abandoning pork as a commodity and marketing pork as a distinctive product. (One example of this is du Breton in Quebec which gains a premium price for pork which is marketed for its health attributes.)

Potatoes - Prince Edward Island has a strong reputation in domestic and international markets, but is losing its competitive position. More efforts should be made to differentiate Prince Edward Island potatoes in the marketplace to re-capture its premium price. As in the case of the "Fresh Obsessions" brand, consumers are willing to pay higher prices for special attributes. Producers can become preferred partners with retailers, regaining stable markets. The idea that if "we grow them they will buy them" no longer works, as evidenced by the surplus of potatoes that will have to be destroyed again this year. More concerted efforts have to be made in marketing Prince Edward Island potatoes for their distinctive qualities, and these efforts must be backed with more attention to service and more cooperation with retailers.

It will be argued that these measures are too long-term to be of benefit to producers who are currently experiencing financial pressures. The Standing Committee recognizes and understands this. However, the consequences of doing nothing will mean that next year, or the year after, or the year after that, yet another Standing Committee will be holding yet another round of hearings on yet another crisis in yet another sector of the industry.

The Standing Committee recognizes that producers want to earn their returns from the marketplace, not from government payments or subsidies. As such, it is recommending a new direction for agriculture aimed at making the industry more sustainable: economically viable, environmentally responsible and socially acceptable.

In making the transition to a more sustainable agriculture, the Standing Committee recognizes that government has a responsibility to help ensure the survival of the industry and to help it face new challenges. The Standing Committee also recognizes that the industry itself is best able to recognize and respond to new and emerging opportunities in the marketplace. New roles and responsibilities will be required to establish new relationships between government, the industry and other sectors of the supply change.

In the end, there is really only one option for agriculture. The status quo is not an option. And the new directions for agriculture being recommended are not a leap in the dark. Around the world, there are literally scores of brand name products that set them apart from the competition, earning consumer loyalty, confidence and market share. Prince Edward Island can become a recognized leader in the production and marketing of distinctive, high quality, branded food products that similarly earn loyalty, confidence and market share. With hard work and commitment, a new vision for Prince Edward Island agriculture can be achieved.

While only a concept, the Standing Committee nonetheless believes this is the most important recommendation it is making in this report. Other crises such as BSE will continue to impact on the industry in the future, but it will be much better able to meet the challenges in the context of an agricultural framework that gives greater control to producers over their own destiny.

18. The Standing Committee recommends that industry, government and supply chain partners collaborate in creating a new direction for Island agriculture by making the transition from an industrialized, commodity-based model to one which is based on product differentiation and branding, building on the Island's pastoral image, isolation, healthy environment and tradition of family farming.

Respectfully submitted,

Wilbur MacDonald
Chairman
Standing Committee on Agriculture, Forestry and Environment

APPENDIX A

Order of Reference

Study Impact of BSE

WHEREAS the beef industry is a significant economic generator in Prince Edward Island;
AND WHEREAS the United States border was closed to all Canadian beef in May following the discovery that one cow in Alberta had tested positive for BSE;

AND WHEREAS the discovery of BSE in Alberta and the subsequent closure of the United States border to Island beef is an issue which has affected many beef producers in Prince Edward Island;

AND WHEREAS the downturn in the beef industry also had a significant detrimental economic impact on Prince Edward Island in general;

AND WHEREAS many Prince Edward Island beef producers are still struggling to recover from this tremendous setback;

AND WHEREAS cow-calf operators in the province appear to have been among the heaviest hit by the BSE crisis;

AND WHEREAS even though it appears Prince Edward Island beef producers may soon be able to ship their product to customers in the United States, there are many Island producers who may not recover;

AND WHEREAS other provinces are looking at the potential long-term ramifications of the BSE crisis on their own beef industries;

THEREFORE BE IT RESOLVED that the Standing Committee on Agriculture, Forestry and the Environment meet as soon as possible to discuss the BSE crisis and its impact on Prince Edward Island in general and cow-calf operators in particular;

AND BE IT FURTHER RESOLVED that this committee invite input from interested stakeholders and others impacted by the BSE crisis in Prince Edward Island so that the implications of this situation can be fully understood and potential remedies identified.

APPENDIX B

Interveners

- Agriculture and Agri-Food Canada
- Agro Co-op
- Eric Artz
- Atlantic Beef Products Inc.
- Atlantic Feeds
- Atlantic Veterinary College
- Atlantic Wholesalers
- Balance It Inc.
- Beaton Fitzpatrick Murray
- Cardigan Feed Services
- Clayton Bulpitt
- Canadian Council of Grocery Distributors
- Canadian Meat Council
- Canadian Imperial Bank of Commerce
- Co-op Atlantic
- Tim Dixon
- Eastern Livestock Equipment
- Farm Credit Canada
- Brendan Flood
- FoodTrust of Prince Edward Island
- Garden Province Meats
- Income Crisis Committee of the Hog Commodity Marketing Board
- Island New Democrats
- Kensington Agricultural Services Ltd.
- Kensington Co-op
- Gordon Lank, Trevor Lank and Susan MacInnis
- Allan Ling and Melvin Ling
- Hon. Kevin MacAdam, Minister of Agriculture, Fisheries, Aquaculture and Forestry
- Clifford McKenna
- National Farmers Union, Region 1, District 1
- PEI Advisory Council on the Status of Women
- P.E.I. Cattlemen's Association Inc.
- Bob Perrin
- Phillips Feed Services
- Prince Edward Island Federation of Agriculture
- Prince Edward Island Hog Commodity Marketing Board
- Prince Edward Island Marketing Council
- Prince Edward Island Milk Marketing Board
- Reddin Farm Equipment
- Gary Renkema

- ShurGain Feeds
- Gordon Sobey and Susan Sobey
- Sobey's
- TIAPEI
- Peter Verleun

APPENDIX C

Committee Members - Standing Committee on Agriculture, Forestry and Environment

Permanent Members:

- Wilbur MacDonald, Chairman (District 6, Belfast-Pownal Bay)
- Wilfred Arsenault (District 24, Evangeline-Miscouche)
- Richard Brown (District 12, Charlottetown-Kings Square)
- Ron MacKinley (District 16, North River-Rice Point)
- Fred McCardle (District 19, Borden-Kinkora)
- Andy Mooney (District 1, Souris-Elmira)
- Hon. Mitch Murphy, Provincial Treasurer (District 20, Kensington-Malpeque)
- Eva Rodgerson (District 25, West Point-Bloomfield)

Substitute Members:

- Jim Bagnall (District 4, Montague-Kilmuir)
- Carolyn Bertram (District 17, Crapaud-Hazel Grove)
- Wayne Collins (District 15, Winsloe-West Royalty)
- Hon. Robert Ghiz, Leader of the Official Opposition (District 13, Charlottetown-Rochford Square)
- David McKenna (District 7, Glen Stewart-Bellevue Cove)